

IRS Fact Sheet

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Third-Party Reporting Reminders

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WASHINGTON—Underreported business income accounts for more than \$100 billion per year in unpaid taxes, according to IRS estimates.

In order to educate taxpayers regarding their filing obligations, this fact sheet, the third in a series, explains the rules pertaining to third-party payer reporting of income.

Third-Party Reporting Promotes Accurate Business Income Reporting

In many cases, the tax law requires third-party payers, such as small businesses or individuals, to report to the IRS payments they have made to subcontractors, attorneys, architects and other service providers.

In fact, experience shows that taxpayers are much more likely to report their income when they receive third-party notification of payments they received. For example, non-farm sole proprietorships, which seldom receive third-party payer notifications, underreport about 57 percent of their business income on Schedule C, Profit or Loss from Business. By contrast, wage earners who receive Form W-2, Wage and Tax Statement, underreport only about 1 percent of their wages.

Form 1099-MISC

Form 1099-MISC, Miscellaneous Income, is most commonly used by third-party payers to report payments made in the course of a trade or business to others for services. Third-party payers should report the following on Form 1099-MISC:

- Payments of \$600 or more for services performed by persons not treated as employees, such as fees to subcontractors, attorneys or accountants
- Rent payments of \$600 or more
- Prizes and awards of \$600 or more that are not for services, such as TV show winnings
- Royalty payments of \$10 or more
- Payments to certain crew members by operators of fishing boats
- Sales of \$5,000 or more of consumer products to a person for resale anywhere other than in a permanent retail establishment
- Any payments from which federal income tax has been withheld under backup withholding rules

There are some exceptions. Form 1099-MISC is generally not required for payments: to a corporation; for merchandise, telephone, freight, storage and similar items; of rent to a real estate agent or a tax-exempt organization; to the United States, any individual state, the District of Columbia, a U.S. possession or a foreign government

Third-party payers must provide a copy of the form to the payee on or before Jan. 31 following the end of the tax year. For example, for services rendered during 2006, a payer must provide the form to its payee by Jan. 31, 2007. The payer must also file Forms 1099-MISC with the IRS by Feb. 28 (March 31, if filing electronically).

Box 7: Non-Employee Compensation

One of the most common entries found on Form 1099-MISC is Box 7 for non-employee compensation. Examples of payments to be reported in Box 7 include:

- Professional service fees, such as fees to attorneys, accountants, architects, contractors and engineers.
- Fees paid by one professional to another, such as fee-splitting or referral fees.
- Payment for services, including payment for parts or materials used to perform the services if supplying the parts or materials was incidental to providing the service.
- Commissions paid to non-employee salespersons that are subject to repayment but not repaid during the calendar year.
- Fees paid to non-employees, including travel reimbursements for which the persons did not account to the payer, if the fee and reimbursement total at least \$600.
- Payments to non-employee entertainers for services.
- Exchanges of services between individuals in the course of their trades or businesses.

Generally, payments reported in Box 7 are subject to self-employment tax by the recipient. If the payments are not subject to self-employment tax, the third-party payer should report them as other income in Box 3.

The IRS encourages businesses to establish reliable record-keeping systems, accurately report all income, properly compute cost of goods sold and other expenses, and report all required third-party payments. According to IRS research, understated business income, including underreported receipts and overstated expenses, is an area where compliance is a concern. In addition to increasing outreach and education in these areas, the IRS will also be focusing enforcement efforts, including examinations, on these issues.